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# HOW DOES THE DIVISION OF POWER BETWEEN THE BOARD AND THE GENERAL MEETING OPERATE?

ABSTRACT

Constitutional provisions generally vest management power in the board of directors and courts have interpreted these provisions as establishing board primacy in managing the company. In *John Shaw & Sons (Salford) Ltd v Shaw*, the English Court of Appeal stated that shareholders unhappy with the way that the board is exercising its management power should either change the allocation of power in the company's constitution or replace the directors. This article explores the feasibility of these two options, comparing the law in Australia and the United Kingdom. It finds that there are a number of legal obstacles to reallocating constitutional power, unless all that is desired is to give the general meeting a veto power. In contrast, the power to replace the board or some of the directors is more straightforward, but requires sufficient voting power and the will to use it, either directly or indirectly.

## I INTRODUCTION

The division of power between the board of directors and the general meeting of members has been relatively settled in Anglo-Australian law since the decision of Lord Clauson in *Scott v Scott*[1] in 1943. This case considered the interpretation of the then default constitutional provision[2] regarding management of a company, which gave management power to the board of directors, subject to regulations passed by the general meeting. The Court read down the general meeting's power to interfere with board decisions by regulation and held that board power in this situation is paramount.

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1 [1943] 1 All ER 582. See also *Leigo v Berner* [1976] 1 NSWLR 502; *Breckland Group Holdings Ltd v London and Suffolk Properties Ltd* (1988) 4 BCC 542.

2 *Companies Act 1929* c 23, sch I, Table A, art 71.

Since then – the default constitutional provisions have been changed in Australia and the United Kingdom to further entrench the management role of the board. In Australia there is no longer any mention of the general meeting in the replaceable rule in s 198A of the *Corporations Act 2001* (Cth), which simply provides that the company is to be managed by or under the direction of the board. In the UK, Table A[3] does not go quite as far, in that it still refers to the possibility of the general meeting giving a direction to the board, but this must be done by special resolution.[4]

What then are the options for shareholders who are unhappy with the management of companies in which they have invested? The Court of Appeal said in *John Shaw & Sons (Salford) Ltd v Shaw*[5] that shareholders unhappy with the board's exercise of management power should either alter the articles of the company (now constitution) or refuse to re-elect the directors of whose actions they disapprove.

The aim of this article is to examine how these two options work in practice. The focus is on listed public companies, in which the division of power between the board of directors and the general meeting of shareholders generally follows the model of a specialised board overseeing the management of the company and shareholders usually adopting a passive role.[6]

## II Altering the Constitution

Shareholders certainly have the power to alter the constitution by special resolution.[7] However, the usefulness of this power will depend on how much management power can be effectively allocated to shareholders.

### A *Shareholder Veto Powers*

The most straightforward situation is where shareholders are given a power of veto, so that some nominated category of conduct cannot take place unless shareholders have approved it (as well as it being approved by the board). This type of reallocation of power is relatively straightforward to draft and would be valid both at general law and under the *Corporations Act 2001* (Cth).

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3 *Companies (Model Articles) Regulations 2008* reg 4, sch 3, in relation to public companies limited by shares. (Schedules 1 and 2 make identical provision in relation to private companies limited respectively by shares and guarantee). These articles come into force on 1 October 2009, but essentially replicate *Companies (Tables A to F) Regulations 1985 (SI 1985/805)* reg 70.

4 The effect of this provision is unclear and is discussed further below Part II(B)(1).

5 [1935] 2 KB 113 ('*Shaw*').

6 The balance of power between the board and the general meeting will vary according to the size and nature of the company. In quasi-partnership companies, for example, there may be a complete overlap between these two organs.

7 *Companies Act 2006* (UK) s 21; *Corporations Act 2001* (Cth) s 136(2).

A softer version of a shareholder veto power is an alteration that requires additional disclosure to shareholders by directors. Again, this type of amendment would be valid, if introduced. An example is provided by *NRMA Ltd v Snodgrass*,[8] which concerned a proposed amendment to require directors elected to the board of NRMA to provide members with full details of their election campaign funding.

### B *Directions to the Board*

More challenging is the possibility of altering the constitution to reallocate power over a particular matter from the board to the general meeting. There are a number of potential obstacles to this approach.

#### 1 *Interpretation Risk*

The first limitation is that the power of the general meeting to give directions to the board by resolution has been interpreted as subordinate to the board's management power. Any attempt to allow shareholders to give directions to the board would therefore require careful drafting to overcome the line of cases that includes *Scott v Scott*[9] and *National Roads and Motorists' Association v Parker*.[10] In both cases a constitutional power in the general meeting to give directions to the board by ordinary resolution was read down and held not to qualify the directors' power to manage the company's business.

It is unclear whether the fact that the default UK constitutional provision in Table A[11] now provides for any directions to the board by the general meeting to be given by *special* resolution is effective to overcome this line of cases. Davies favours the view that shareholders could give an effective direction to the board under this type of provision, and could even force directors to enter into a prospective transaction by this means.[12] Although this may be the case in the UK, it is not clear that an Australian court would adopt this approach. Some Australian commentators favour an approach based on *Scott v Scott*[13] to the effect that shareholders could pass such a resolution, but that the board would not be bound to act in accordance with the direction.[14] However, it may be that the board could prevent a resolution designed to make a direction even being put to the general meeting for a vote. In the Australian case of *Parker*,[15] a proposed ordinary resolution to give a direction to the board was held not to be for a proper purpose, and so could not be passed by the members in general meeting. The board was therefore not obliged to give effect to a requisition

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8 [2001] NSWSC 76; aff'd (2001) 52 NSWLR 383.

9 [1943] 1 All ER 582.

10 (1986) 6 NSWLR 517 ('*Parker*'). See discussion below following n 44.

11 *Companies (Model Articles) Regulations 2008* sch 3, reg 4. See above n 3.

12 Paul L Davies, *Gower and Davies' Principles of Modern Company Law* (7th ed, 2003) 304.

13 [1943] 1 All ER 582.

14 Harold Ford, Robert Austin and Ian Ramsay, *Ford's Principles of Corporations Law* (current to service 61, June 2008) [7.120].

15 (1986) 6 NSWLR 517.

for a meeting to consider the resolution. Whether a constitutional provision that contemplated directions being given by special resolution is distinguishable is an open question.

2 *Directors' Duties*

The second limitation is that because management power is confided to the board, directors will usually be involved in implementing the general meeting's directions. This causes potential problems because directors owe duties to the company. For example, what would be the position if the constitution were altered to give shareholders power to give directions to directors in respect of a particular nominated matter, but the directors considered the directions to be contrary to the company's best interests?[16] There are several steps involved in answering this question.

The first step, which relates back to the issue of 'interpretation risk' discussed above is to identify whether or not the direction is binding on the directors. If it is not, and the directors choose to give effect to the direction, the direction will not qualify the directors' obligation to comply with their duties.

Assuming that it is possible to draft a constitutional provision that is binding on directors, arguably[17] it would be possible for this provision also to modify the directors' duties,[18] so that there would be no breach of fiduciary duty by the directors in giving effect to the shareholders' directions. However, in Australia, overcoming directors' statutory duties is not so straightforward.

It has been held that shareholders cannot release directors from the statutory duties imposed by the *Corporations Act 2001* (Cth) after the breach of duty has occurred.[19] This is especially the case where the statute imposes criminal liability.[20] An open question is whether advance authorisation by the general meeting (as opposed to ratification) might be capable of taking conduct out of the realm of 'impropriety'. Chief Justice Gleeson and Heydon J averted to this possibility in *Angas Law Services Pty Ltd v Carabelas*,[21] as did Santow J in *Miller*.[22] If this were possible, it would be most appropriate in relation to breaches of the statutory duties in ss 182 and 183 regarding improper use of information and position and the duty in s 181(1)(b) to act for proper purposes, since permission for the specific conduct could be argued to render the conduct no longer 'improper'. It is less clear that this approach could be applied to the statutory duties in ss 180 and 181(1)(a) regarding,

16 This hypothetical was posed by the Full Federal Court in *Capricornia Credit Union Ltd v ASIC* (2007) 159 FCR 69.

17 Cf *Capricornia Credit Union Ltd v ASIC* (2007) 159 FCR 69.

18 See, by analogy, *Levin v Clark* [1962] NSWR 686.

19 *Angas Law Services Pty Ltd (in liq) v Carabelas* (2005) 226 CLR 507.

20 *Miller v Miller* (1995) 16 ACSR 73, 89 ('*Miller*').

21 (2005) 226 CLR 507, [32].

22 (1995) 16 ACSR 73, 89. See also *Marson Pty Ltd v Pressbank Pty Ltd* (1987) 12 ACLR 465, 472.

respectively, acting with care and diligence and in good faith in the best interests of the corporation. These duties are not qualified by the notion of propriety, but rather are cast in more absolute terms. If advance authorisation cannot affect the content of these duties, this would lead to the result that directors could potentially be in breach of their statutory duties in giving effect to a binding direction from shareholders if they considered the directed conduct to be against the interests of the company and did nothing to attempt to address that dilemma.

### 3 *Prohibition on Exempting/Indemnifying Directors from Liability*

A further potential difficulty with attempting to relieve directors from liability for breach of their duty of care and duty to act in the best interests of the company is the statutory prohibition on provisions exempting or indemnifying directors from breach of duty.[23] This issue was referred to by the Federal Court in *Capricornia Credit Union Ltd v ASIC*,[24] but not explored in detail. However, it was considered to a greater degree in the United Kingdom by Vinelott J in *Movitex v Bulfield*,[25] a decision that concerned directors' general law duties.

In *Movitex v Bulfield*,[26] Vinelott J had to consider the validity of constitutional provisions modifying the self-dealing rule (that is, the rule that requires fiduciaries to avoid entering into transactions that would give rise to a conflict of interest or conflicting duties ) in light of a predecessor of s 232 of the *Companies Act 2006* (UK).[27] The effect of the constitutional provisions was to exclude the self-dealing

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23 This prohibition was introduced in the United Kingdom on the recommendation of the Greene Committee (*Company Law Amendment Committee 1925–1926*, Cmd 2657, recommendation 47) following the decision in *Re City Equitable Fire Insurance Co Ltd* [1925] Ch 407, where Romer J would have been prepared to have found that the directors had breached their duty of care, skill and diligence, except that there was a provision in the company's articles exempting them from liability other than that arising from 'wilful neglect or default'. The modern versions of these provisions are found in *Companies Act 2006* (UK) s 232 and *Corporations Act 2001* (Cth) s 199A. The United Kindom provision renders void (subject to some limited exceptions) provisions either in the company's constitution or in a separate contract exempting a director from (or indemnifying them in respect of) liability for negligence, default, breach of duty or breach of trust in relation to the company. The Australian prohibition on exemption from liability applies to any liability to the company incurred as an officer or auditor of the company. The prohibition on indemnifying an officer applies not only to liability to the company, but also to liability for a pecuniary penalty order under s 1317G or a compensation order under s 1317H or 1317HA. It also applies to liabilities to a third party involving lack of good faith. There is an exception for reimbursement of the legal costs and expenses of a successful defence or application for judicial relief under s 1318 or s 1317S.

24 (2007) 159 FCR 69, [76].

25 [1986] 2 BCC 99, 403.

26 Ibid.

27 The relevant provision was *Companies Act 1985* (UK) s 205. It was slightly wider than the current provision, as it applied to officers of the company and its auditor, whereas the current provision is restricted to directors.

rule, subject to two qualifications: a requirement for the director to declare their interest and a prohibition on the director voting or being counted in the quorum in respect of the transaction.

His Lordship rejected the distinction advanced by the editors of *Gore Browne on Companies*[28] between reducing or abrogating a duty owed by a director and exempting the director from liability for breach of it.[29] Instead, he adopted the approach taken by Megarry VC in *Tito v Waddell (No 2)*,[30] which was to treat the self-dealing rule as a disability rather than a duty, and therefore not caught by the prohibition on exempting or indemnifying a director from breaches of duty. As Vinelott J explained:

> I do not think it is strictly accurate to say that a director of a company owes a fiduciary duty to the company not to put himself in a position where his duty to the company may conflict with his personal interest or with his duty to another. The true rule is that if a director puts himself in such a position then (unless he can rely on a provision entitling him to do so in the articles) the transaction will be set aside ex debito justitiae and without enquiring into the fairness of the transaction. [31]

This decision therefore effectively means that the statutory prohibition on indemnifying directors would apply to attempts to relieve directors from breaches of the duty to act in the company's best interests and the duty of care, but not from breaches of the 'disabilities' relating to conflicts of interest.

It is not clear whether an Australian court would adopt this distinction, as the Australian High Court has taken a different view as to the nature of fiduciary duties. For example, in *Breen v Williams*[32] Gaudron and McHugh JJ said:

> In this country, fiduciary obligations arise because a person has come under an obligation to act in another's interests. As a result, equity imposes on the fiduciary proscriptive obligations—not to obtain any unauthorised benefit from the relationship and not to be in a position of conflict. If these obligations are breached, the fiduciary must account for any profits and make good any losses arising from the breach. But the law of this country does not

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28 A J Boyle and Richard Sykes, *Gore Browne on Companies* (43rd ed, 1977).

29 His Lordship noted that one consequence of this interpretation would be that 'an article could, without infringing s 205, modify a director's duty to use reasonable skill and care in the conduct of the company's affairs and so avoid liability for damages for breach of duty which would otherwise arise, a conclusion which seems to me manifestly in conflict with the purpose of the section'.

30 [1977] Ch 106.

31 [1986] 2 BCC 99, 403, 99, 440.

32 (1996) 186 CLR 71.

> otherwise impose positive legal duties on the fiduciary to act in the interests of the person to whom the duty is owed … .[33]

Adopting the language of Vinelott J, the High Court would view all fiduciary duties as 'disabilities' (and consequently, on Vinelott J's reasoning, amenable to exemption or indemnity without contravening the statutory prohibition), although Australian courts would arguably concede a positive duty of care.[34] However, it is likely that an Australian court would approach this question from a different starting point.

First, s 199A refers to 'liabilities' rather than to 'duties', so that whether the obligation giving rise to the liability is prescriptive or proscriptive is not relevant for the purposes of the Australian prohibition on indemnities. Secondly, there is the added complication that directors have statutory duties that may give rise to liabilities (apart from their general law duties). In *Miller*,[35] Santow J considered that a ratifying resolution did not breach a predecessor of s 199A. This was on the basis that the section 'is concerned with "blank cheque" indemnification and exemption, while ratification requires specific release after full disclosure of the particular cause for claim.'[36] In that case, Santow J also drew a distinction between absolving a party from liability for the consequences of a breach of duty and releasing the rights which give rise to those obligations, although this latter distinction was questioned in *Eastland Technology Australia Pty Ltd v Whisson*.[37]

Whichever line of reasoning from *Miller*[38] is pursued, there are potential problems in a reallocation of constitutional power to shareholders. First, the constitutional provision would be likely to take the form of a blank cheque rather than a specific absolution, since it would necessarily apply to circumstances that would not be capable of being stated with precision at the time of drafting. The second line of reasoning in *Miller*,[39] which argues that liability does not arise (and therefore section 199A is not engaged) if the shareholders have prospectively authorised the conduct, encounters the problems referred to earlier regarding the uncertainty as to the ability to authorise conduct that would otherwise breach directors' statutory duties.

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33 (1996) 186 CLR 71, 113. See also 137–8 (Gummow J). This approach is affirmed in *Pilmer v Duke Group Limited (in liq)* (2001) 207 CLR 165, 198.

34 This is because the duty of care has been regarded as equitable but not fiduciary: *Permanent Building Society v Wheeler* (1994) 11 WAR 187. The same distinction has been drawn in respect of solicitors' duties in some English cases: see *Bristol & West Building Society v Mothew (t/a Stapley & Co)* [1996] 4 All ER 698 (Court of Appeal); *Mortgage Express Ltd v Bowerman & Partners (a firm)* [1996] 2 All ER 836 (Court of Appeal); *Clark Boyce v Mouat* [1994] 1 AC 428 (Privy Council).

35 (1995) 16 ACSR 73.

36 Ibid 88.

37 [2005] WASCA 144.

38 (1995) 16 ACSR 73.

39 Ibid.

Thus, any attempt to allocate power to the general meeting that still required the mediation of the board to give effect to the general meeting's decision would face considerable uncertainty.

### C *Complete Transfer of Power to Shareholders*

This then raises the question whether it would be possible to allocate the power to the general meeting in a way that also empowered the general meeting to give effect to the decision. This is certainly a theoretical possibility, although it would face some practical implementation obstacles in a widely-held company. It might also face the risk that the members charged with implementing the resolution would be subject to fiduciary and statutory obligations as de facto directors and therefore subject to similar potential conflicts to the directors.[40] Moreover, it could be argued that this would not completely eliminate the directors' duty issue outlined above, since the appointed directors could still form the view that the shareholders' conduct was not in the best interests of the company and feel compelled to intervene.[41] A counter argument is that if directors have no power in relation to a particular matter, they would no longer have a duty regarding the matter. It is unclear which view would be taken by a court.

### D *Commentary*

The above discussion on adjusting the allocation of power between directors and shareholders raises a number of issues, several of which are controversial. The purpose of this discussion is not to attempt to resolve those difficult questions, but rather to highlight areas of legal uncertainty which present risks and which may therefore act as constraints on a reallocation of power between the board and the general meeting. However, one issue in relation to which the legal position seems clear is that giving shareholders a negative power to approve or veto a transaction is unproblematic. This is, however, a much more limited notion than appears to have been contemplated in the English Court of Appeal's dictum in *Shaw*.[42]

### E *Tactical Use of the Power to Propose Alterations to the Constitution*

There is another facet of the shareholders' power to alter the constitution that should be mentioned, although it was arguably not in the mind of the English Court of Appeal in *Shaw*.[43] The power to place proposed amendments to the constitution on the agenda for a general meeting can be an avenue for shareholder activism, irrespective of whether the resolution is passed.

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40 See, eg, *Adams v Adhesives Pty Ltd* (1932) 32 (NSW) 398, 401–2; *Re Ariadne Australia Ltd* [1991] 2 Qd R 377, 379.

41 This view is supported in a slightly different context by Neil Pathak and Hugh Lauritsen, 'A shareholder's right to call general meetings – a sharp sword for the disgruntled shareholder or just a blunt instrument?' (2005) 23 *Company & Securities Law Journal* 283.

42 [1935] 2 KB 113.

43 Ibid.

*Parker*[44] decided that directors may disregard requisitions that call for a general meeting to be held to consider resolutions that could not be effectively passed by that meeting. In *Parker*'s case, this meant that the board was not obliged to convene a general meeting to consider resolutions containing directions to the board as to the conduct of board elections, since this was not a matter that was in the power of the general meeting. The ability of shareholders to comment on and question management has since been guaranteed by statute in Australia.[45] However, it remains the case that shareholders cannot formally express their views about management decisions by way of a resolution.

Later in his Honour's reasons in *Parker's* case, McLelland J said:

> As I see the matter, the only power vested in a general meeting of members which might be available to attain the object set out in the requisitions would be the passing of a special resolution altering the articles of association appropriately.[46]

Thus, members seeking to place management-related matters on the agenda for a meeting can frame their resolution in terms of an alteration to the constitution. While this tactic will not secure passage of the resolution, it will ensure that the resolution is at least put to the meeting and voted on.

On its own, the power to propose an amendment to the constitution has not proved problematic. It has, however, become controversial in Australia when combined with the fact that a general meeting can be called on the request of 100 members (as an alternative to a request by five per cent of members).[47] The controversy has concerned not only the cost of calling a special general meeting,[48] but the fact that the purpose of the meeting has in some cases been to raise 'stakeholder' concerns such as the company's employment conditions or environmental record.[49] There have been numerous calls for reform[50] of the relatively generous 100–member

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44 (1986) 6 NSWLR 517.

45 *Corporations Act 2001* (Cth) s 250S.

46 (1986) 6 NSWLR 517, 522–523.

47 *Corporations Act 2001* (Cth) s 249D.

48 Stephen Bottomley, *The Role of Shareholders' Meetings in Improving Corporate Governance*, Research Report (2003) found that the median cost of holding an annual general meeting in Australia was AU$15 000, and the average cost was AU$44 042. The cost in very widely-held corporations may, however, be higher. In *National Roads and Motorists' Association Ltd v Snodgrass* (2002) ACSR 371, 373, the group secretary and general counsel of NRMA, in affidavit evidence, estimated the cost of calling a meeting of that company separate from the annual general meeting to be in the order of $2.6m. If the meeting were held on the same date then her estimate was a cost of at least $1.4m.

49 See Kate Askew and Anne Lampe, 'What a to-do when investors get stroppy', *Sydney Morning Herald* (Sydney), 14 February 2005, 40.

50 See, eg, Parliamentary Joint Statutory Committee on Corporations and Securities, Parliament of Australia, *Report on Matters arising from the Company Law*

threshold,[51] but it has not been possible to secure agreement from the required number of State Attorneys-General.[52]

Modification of the statutory thresholds for calling a meeting is not possible via constitutional amendment. However, it is possible for companies to provide in their constitutions that a special resolution amending the constitution 'does not have any effect unless a further requirement specified in the constitution relating to that modification or repeal has been complied with'.[53] At least one Australian company has taken advantage of that power to curtail the tactical use of the general meeting power to alter the constitution. In 2003, Boral Ltd amended its Constitution to introduce a provision requiring that any special resolution to modify or repeal the constitution or a provision of it, must either have been: approved by a resolution of the Board or included in a notice of general meeting given to shareholders as a resolution proposed by shareholders with at least five per cent of the votes that may be cast on the resolution.

This amendment effectively means that retail shareholders in that company will not be able to propose alterations to the constitution without the support of institutional shareholders, since summoning five per cent of the votes in favour of such alteration will generally require the involvement of institutions. Arguably a more satisfactory solution would be one that addresses the thresholds for calling a meeting and the content of the proposed resolution rather than the power of alteration of the constitution.

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*Review Act 1998* (1999) [15.21]; Company and Securities Advisory Committee, *Shareholder Participation in the Modern Listed Public Company* (2000), Recommendation 2; *Corporations Amendment Regulations 2000 (No. 4)* (Cth) reg 2G.2.01, passed in April 2000 under s 249D(1A) *Corporations Act 2001* (Cth) in April 2000 (subsequently disallowed by the Senate on 28 June 2000), Exposure Draft Corporations Amendment Bill (No 2) 2006 sch 1, item 1; Parliamentary Joint Committee on Corporations and Financial Services, Parliament of Australia, *Better shareholders – Better company: Shareholder engagement and participation in Australia* (2008) [3.91].

51 Cf the position in the United Kingdom, where calling a meeting of members of a public company requires a request from ten per cent of shareholders and proposing a resolution requires a request from five per cent of shareholders or at least 100 members with an average paid up sum per member of at least £100: ss 303 and 338 *Companies Act 2006* (UK). In Australia, both powers can be exercised by 100 members or five per cent of shareholders: *Corporations Act 2001* (Cth) ss 249D, 249N.

52 Under clause 507(2) of the *Corporations Agreement 2002* (between the Commonwealth, States and Territories), the approval of at least three State or Territory Ministers (of whom at least two must be State Ministers) is required for a Commonwealth Bill to amend this part of the *Corporations Act 2001* (Cth).

53 *Corporations Act 2001* (Cth) s 136(3).

## III Appointing and Removing Directors

The other option identified by the Court of Appeal in *Shaw*[54] for shareholders who are dissatisfied with management is to exercise the power to appoint and remove directors. In contrast to the power to alter the constitution, exercising this power is legally straightforward.

### A *Appointment*

Both United Kingdom and Australian legislation allow considerable latitude in the appointment of directors, although both have default rules that the company may choose to displace. In Australia, the replaceable rule in s 201G confers the appointment power on the general meeting, but s 201H gives the board the power to fill casual vacancies, subject to later confirmation by the general meeting. In the UK, Table A provides for directors to be appointed either by the company in general meeting or by the directors.[55] One legislative guarantee in both countries, however, is the requirement that directors be appointed individually.[56]

There are no legislative requirements regarding nomination of potential candidates for board positions.[57] Thus, in the absence of a constitutional limitation, a nomination can be made by a single member, which can make this an effective tool for activism by retail shareholders.[58] In recognition of this, one major Australian company has amended its Constitution to require that nominations for the position of director be made either by 100 members or by five per cent of shareholders,[59] but constitutional restrictions of this kind are not widespread. As a practical

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54 [1935] 2 KB 113.

55 See *Companies (Model Articles) Regulations 2008* (UK) reg 20, sch 3, in relation to public companies limited by shares. Schedule 1 regulation 17 and schedule 2 regulation 17 *Companies (Model Articles) Regulations 2008* (UK) make identical provision in relation to private companies limited respectively by shares and guarantee. These articles come into force on 1 October 2009 but essentially replicate *Companies (Tables A to F) Regulations 1985 (SI 1985/805)* regs 78–9.

56 *Companies Act 2006* (UK) s 160; *Corporations Act 2001* (Cth) s 201E. No such requirement applies to their removal: *Taylor v McNamara* [1974] 1 NSWLR 164; *Claremont Petroleum NL v Indosuez Nominees Pty Ltd* [1987] 1 Qd R 1; *NRMA Ltd v Scandrett* [2002] NSWSC 1123.

57 ASX Listing Rule 14.3 requires listed entities to accept nominations up to 35 business days before a general meeting at which directors may be elected, unless the entity's constitution provides otherwise (the period is reduced to 30 business days if the meeting has been called at the request of members).

58 See, eg, David Elias, 'Irritating questions high on agenda', *The Age* (Melbourne), 9 December 2000, 3; Elizabeth Gosch, 'WAN's "out of control" editor comes under fire', *The Australian* (Sydney), 10 November 2007, 35; 'Mystery pair vie for BHP board', *Herald Sun* (Melbourne), 12 August 1998, 29.

59 Boral Ltd Constitution [6.2(f)]. The clause is actually drafted by reference to the members specified in the *Corporations Act* as being entitled to give notice of a resolution that they propose to move at a general meeting of the Company.

matter, candidates who are not supported by the board are seldom elected, since institutional shareholders will generally vote with management.[60]

### B *Removal*

The right of the general meeting to remove a director by ordinary resolution was introduced in the United Kingdom by the *Companies Act 1948*.[61] Current versions of the provision[62] serve two functions: to guarantee to shareholders the right to remove directors by ordinary resolution, and to provide natural justice to directors by requiring special notice of the meeting to be given and giving directors an opportunity to put their case to members. One difference between the two countries is that in Australia, the right to remove directors by ordinary resolution can be displaced in proprietary companies[63] by a contrary constitutional provision.[64]

There is some uncertainty concerning the status of constitutional provisions that provide for an alternative procedure for removing directors in public companies. They clearly cannot prevent shareholders from exercising their statutory rights, but do they provide an alternative means by which directors can be removed from office? Earlier versions of the Australian statutory provision preserved the operation of these constitutional provisions.[65] However, there is no reference to them in the current version of either the United Kingdom or Australian legislation.

Some Australian decisions continued to give effect to these alternative means for shareholders to remove directors, even after the guarantee of their continued operation was removed from the statute and the right to remove directors was designated as a mandatory provision.[66] This approach gave priority to shareholders' rights over the natural justice rights for directors that are also provided for by statute. However, a more recent Australian decision, *Scottish & Colonial Ltd v Australian Power & Gas Co Ltd*,[67] rejects this approach. This divergence in decisions illustrates a more general interpretation dilemma created by the move away from a 'belt and braces' drafting style in the corporations legislation to 'plain English' drafting.[68] This confusion is compounded when no explanation is

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60 See, eg, Paul Garvey, 'Non-exec directors sit pretty' *Australian Financial Review* (Sydney), 27 June 2008, 28.

61 Sweet & Maxwell, *Palmer's Company Law* (current to service 30 April 2007) [1.110].

62 *Companies Act 2006* (UK) ss 168–9; *Corporations Act 2001* (Cth) s 203D.

63 *Corporations Act 2001* (Cth) s 203C.

64 This outcome can, however, generally be achieved in private companies in the UK by weighted voting: see *Bushell v Faith* [1970] AC 1099; or by an unanimous shareholders' agreement not to use the power: see Sweet & Maxwell, *Palmer's Company Law* (current to service 30 April 2007) [8.1319]-[8.1320].

65 See, eg, *Link Agricultural Pty Ltd v Shanahan*, *McCallum & Pivot Ltd* [1999] 1 VR 466 regarding *Corporations Law* (Cth) s 227.

66 See, eg, Allied Mining & Processing Ltd v Boldbow Pty Ltd (2002) 26 WAR 355.

67 [2007] NSWSC 1266.

68 See also Elizabeth Boros, 'Virtual Shareholder Meetings: Who Decides how Companies Make Decisions?' (2004) 28 *Melbourne University Law Review* 265.

provided in the relevant explanatory memorandum for omitting some aspects of the original provisions. In this information vacuum, it is submitted that the statutory interpretation approach adopted in *Scottish & Colonial Ltd v Australian Power & Gas Co Ltd*[69] has much to commend it,[70] as it promotes both policy goals expressed in the section.[71] This interpretation issue has not been tested by litigation in the UK, although the approach adopted in *Scottish & Colonial Ltd v Australian Power & Gas Co Ltd*[72] is favoured by one commentator.[73]

The fact that shareholders have an absolute right to remove directors at any time means that they can indirectly influence the board of directors.[74] However, one practical barrier to their exercising this power in cases of alleged director misconduct is the fact that s 249P of the *Corporations Act 2001* (Cth) states that a company need not distribute a statement at the request of directors if it is defamatory. In *NRMA v Snodgrass*[75] the court was not prepared to sever defamatory statements or to take account of the potential availability of defences to defamation. The company was therefore able to obtain a declaration that it was not obliged to circulate a statement that might be construed as alleging that a person charged with carrying out some functions for the NRMA had advanced his own interests in an improper way and that particular directors had engaged in a cover up.

One other key difference between the legislation in the two countries is s 203E of the Australian Act. This section prohibits directors of public companies from removing their co-directors, whereas the articles of a UK company may provide for this.[76] Section 203E came to public prominence in 2004 when Coca-Cola Amatil

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69 [2007] NSWSC 1266.

70 See also *Sons of Gwalia Ltd v Margaretic* (2007) 231 CLR 160. Cf Jean J Du Plessis and James McConvill, 'Removal of Company Directors in a Climate of Corporate Collapses' (2003) 31 *Australian Business Law Review* 251; James McConvill and Evan Holland, '"Pre-nuptial Agreements" for removing directors in Australia – are they a valid part of the marriage between shareholders and the board?' [2008] *Journal of Business Law* 204.

71 However, whether as a matter of policy it is desirable that only shareholders should have power to remove directors is a separate question: see discussion below and also Stephen Knight, 'The removal of public company directors in Australia: time for a change?' (2007) 25 *Company & Securities Law Journal* 351.

72 [2007] NSWSC 1266.

73 Sweet & Maxwell, *Palmer's Company Law* (current to service 30 April 2007) [8.1325].

74 See also Paul Davies, *Gower and Davies' Principles of Modern Company Law* (7th ed, 2003) 310; Yuval Millo and Robert Wearing, 'Activist Investors: Some Implications for Corporate Governance' (Paper presented at the European Accounting Association, 31st Annual Congress, Rotterdam, April 2008) available at <http://ssrn.com/abstract=1134729> on 25 September 2010; discussion in Part IV below.

75 [2002] NSWSC 811.

76 Davies, above n 74. See also the examples cited there: *Bersel Manufacturing Co Ltd v Berry* [1968] 2 All ER 552; *Lee v Chou Wen Hsien* [1984] 1 WLR 1202.

Ltd (CCA) asked its directors to sign 'prenuptial' agreements agreeing to resign if the remainder of the board resolved that their appointment be terminated.[77] The Australian Securities and Investments Commission responded to this issue by publishing an information release[78] stating that these agreements are ineffective, as only shareholders can remove directors of a public company, and CCA amended its arrangements accordingly.[79]

It is possible to circumvent this stipulation to some extent by constitutional provisions identifying situations in which a director's appointment is automatically terminated, without any positive action being taken by the directors,[80] or by directors providing an undated letter of resignation to the chairman.[81] This, however, begs the question whether or not it is desirable that directors have a concurrent power to remove other directors. The main argument in favour would be the desirability of being able to remove a director involved in conduct damaging to the company, without the delay involved in convening a general meeting,[82] and the possible obstacles imposed by restriction on circulating potentially defamatory material.[83] The counter-argument is that having the threat of removal hanging over a director may inhibit them from bringing their independent judgement to bear on the matters that come before the board. Knight argues that the threat of liability for breach of duty would override any such inhibition.[84] However, the consequence for the minority director(s) of following their conscience might well be that the other directors exercise their removal power.[85]

### C *Use of Company Resources*

Directors must take care when spending company funds in respect of contested elections to the board, to stay on the right side of the line between permissible provision of factual information to promote an informed election and impermissible campaigning and soliciting of votes. In *Advance Bank Australia Ltd v FAI*

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77 Stuart Wilson, 'Prenuptials usurp investors' rights' *The Australian* (Sydney), 24 August 2004, 27.

78 Australian Securities and Investments Commission, 'Removal of directors of public companies' (Information Release, 17 August 2004).

79 ASX announcement, 'Coca-Cola Amatil amends directors' letters of appointment' lodged 9 August 2004. Cf Jennifer G Hill, 'The Shifting Balance of Power Between Shareholders and the Board: News Corp's Exodus to Delaware and Other Antipodean Tales' (Legal Studies Research Paper No 08–06, The University of Sydney, Sydney Law School, 2008) and (Law and Economics Research Paper No 08–06, Vanderbilt University Law School) 78–80.

80 See Ford, Austin and Ramsay, above n 14, [7.240]; Knight, above n 71, 355.

81 Pamela Williams, 'Strong-arm tactics in the boardroom' *Australian Financial Review* (Sydney), 15 November 2006, 64.

82 See also Knight, above n 71, 362.

83 See discussion above in text accompanying n 76.

84 Above n 71, 361–2.

85 See, eg, *Lee v Chou Wen Hsien* [1984] 1 WLR 1202.

*Insurances Ltd*[86] the New South Wales Court of Appeal held[87] that in the context of an election campaign, self-serving statements about the company's success and the high performance of the present directors was a misuse of company funds,[88] as was the partisan information and emotional language of the script for the company's telemarketing campaign, which included phrases appealing to the shareholders to 'stand behind the Board'.[89]

Howver, some uncertainty remains regarding the standing of a shareholder to challenge a breach of duty by directors in this regard. President Kirby averted to this issue in *Advance Bank Australia Ltd v FAI Insurances Ltd*.[90] However, this was not raised until the appeal, when it was conceded by all parties that it was too late to challenge the shareholder's standing. As a breach of directors' duties is a wrong to the company, the traditional remedy for a shareholder would be to seek leave to bring a derivative action.[91] This course of action has well-documented disadvantages.[92] However, it would alternatively be open to a shareholder to complain that the board's conduct amounted to oppressive or unfairly prejudicial conduct of the company's affairs or to bring an action under s 1324 of the *Corporations Act 2001* (Cth) in respect of a breach of the directors' statutory duties in sections 180–184.[93]

## IV The Impact of Shareholder Demographics

Reference has been made in this article to the fact that the power to exercise the rights of the general meeting in listed public companies effectively resides with institutional rather than retail shareholders. Institutional shareholders own a majority of shares in the United Kingdom[94] and, if not a majority, then a very substantial proportion of shares in listed Australian companies.[95] If a breakdown

86 (1987) 9 NSWLR 464.

87 President Kirby delivered the leading judgment, with which Glass JA agreed; Mahoney JA delivered a separate concurring judgment.

88 (1987) 9 NSWLR 464, 486.

89 Ibid 487.

90 Ibid 470–1.

91 See *Lee v Chou Wen Hsien* [1984] 1 WLR 1202.

92 See also Elizabeth Boros and John Duns, *Corporate Law* (2007) ch 14.

93 Despite initial uncertainty arising from *Mesenberg v Cord Industrial Recruiters* (1996) 39 NSWLR 128, more recent cases have countenanced s 1324 being used by shareholders to establish standing to challenge breaches of directors' duties. See *Idameneo (No 123) Pty Ltd v Symbion Health Ltd* (2007) 165 FCR 19; *ENT Pty Ltd v Sunraysia Television Ltd* [2007] NSWSC 270.

94 Office for National Statistics, *Share Ownership 2006* (2007) [3.8] available at <http://www.statistics.gov.uk/downloads/theme_economy/Share_Ownership_2006.pdf> on 16 June 2008.

95 See Australian Bureau of Statistics, National Accounts Financial Accounts, 5232.0, Table 40: the Listed Shares and Other Equity market; Geofrey P Stapledon, 'Share Ownership and Control in Listed Australian Companies', April 1999 available at <http://ssrn.com/abstract=164129> on viewed 8 May 2008.

were available on the composition of overseas shareholders in Australian companies, the proportion of shares in institutional hands would probably also be a majority. The significance of this distribution of holdings is magnified by the fact that the size of individual institutional holdings in particular companies is also generally much greater than the size of individual retail shareholdings.

In many situations, institutional shareholders' conflicts of interest and diversified portfolios will mean that they have little incentive for exercising their voting power in particular companies.[96] To the extent that institutions are active, this generally takes the form of private meetings with individual companies, rather than publicly via the general meeting process,[97] although there have been some notable recent exceptions.[98]

Although an alteration to the constitution requires the passage of a special resolution, the terms of the resolution can be fine-tuned in advance in consequence of behind-the-scenes influence by one or more institutional shareholders. Changes to the composition of the board can be achieved discreetly by resignations and use of the board's power to fill casual vacancies. In these situations, shareholders are not always exercising their rights directly, but are rather negotiating with companies in the shadow of those rights.[99] The division of power then becomes a division between substantial shareholders on the one hand and the board and management on the other hand, rather than strictly a division between the general meeting and the board.

## V Conclusion

*Shaw*[100] offered shareholders unhappy with management two options: altering the constitutional arrangements to give themselves greater power, or replacing the directors with people more likely to act in accordance with their wishes.

The first option is fraught with legal uncertainty, unless shareholders are content merely to give themselves a power of veto over the particular matter. However, the power to propose an alteration to the constitution means that shareholders can at least ensure that the subject of the alteration is debated.

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96 See generally Geofrey Stapledon, *Institutional Shareholders and Corporate Governance* (1996).

97 Ibid.

98 John Durie, 'Ryan may be driven to quit as Transurban vote takes its toll' *The Australian* (Sydney), 29 October 2008, 48; Adele Ferguson, 'Investors take a shot at directors', *The Australian* (Sydney), 27 October 2008, 27.

99 See, eg, John Armour, 'Enforcement Strategies in UK Corporate Governance: A Roadmap and Empirical Assessment' (Law Working Paper No 106/2008, European Corporate Governance Institute, 2008); Jennifer Hill, 'Visions and Revisions of the Shareholder' (2000) 48 *American Journal of Comparative Law* 39, 72–8; Julian Sher, 'The changing role of institutional investors in Australia – A paradigm shift?' (2007) 21 *Australian Journal of Corporate Law* 81, 100–1.

100 [1935] 2 KB 113.

In contrast, the second option is straightforward to exercise, and is merely a matter of having sufficient voting power and the will to exercise it. In listed companies, majority voting power generally resides with institutional shareholders, whose preferred mode of interaction with companies is usually behind closed doors rather than by a showdown at a meeting. Their voting power is therefore more likely to be exercised indirectly rather than directly. There are nevertheless instances of changes to board composition which have come about as a result of institutional influence, negotiated in the shadow of legal power.